RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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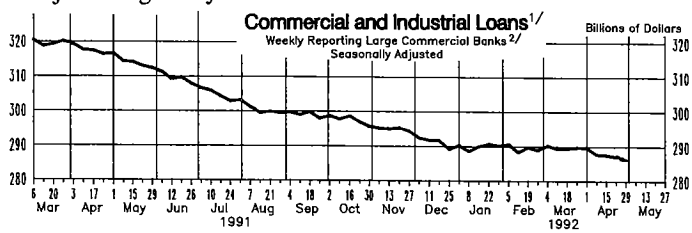
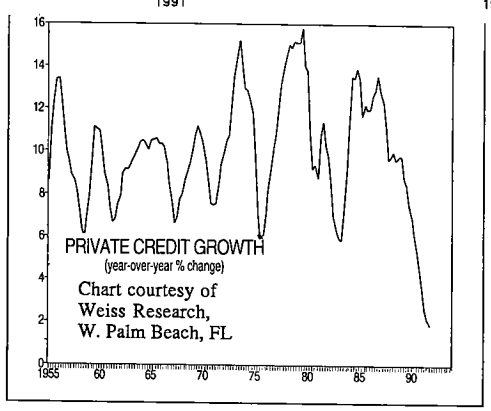
TRUTH or LIES? Inflation: The Labor Department's latest report shows the Consumer Price Index for April up 0.2%. This means that consumer prices are going up at the rate of only 2.4% a year. Is there anyone in America who really believes these figures? I know I don't. By the way, the Bureau of Labor Statistics' Index of 13 Basic Commodities (a lead indicator for inflation) is up from 263 in February to a current 278, a rise of 5.7% in only three months. *Sindlinger's* inflation index for April, by the way, is 12.79%, a figure which I believe is far more accurate.

Economy: The government and most economists are telling us that the recession is behind us. Sounds good, but if true, why does this latest chart from the St. Louis Federal Reserve show Commercial and Industrial Loans at a new low? And if the economy is really expanding, why is private credit growth collapsing? And why are cars selling at a very sluggish annual rate of only 5.7 million? And if the recession is history why were April housing starts down a thumping 17% (biggest drop in eight years) and housing permits down 3%? And if the recession is over, why are bonds strong? Or am I just being too cynical?





THE DOW: When many leading corporations announce stock splits, it's usually a sign of distribution. In recent weeks the following stocks have announced splits: Merck, Procter & Gamble, Coca Cola, Disney, Johnson & Johnson. All but Johnson are in the Dow, and for the first time in history the divisor for the Dow will drop below 0.5 (the new divisor will be 0.468). This means that every one point rise in any Dow stock will increase that Average by over two points. If every stock in the Dow rises one point on any given day, the Dow will advance by 62 points. Therefore, look for increasing volatility in the Dow.

THE PICTURE: I've talked a lot about valuation -- valuation from the standpoint of dividend yields, price/earning ratios and price-to-book value. Valuation tells us where stocks are from the standpoint of the big picture, but valuation studies can obviously not be used for pinpoint timing.

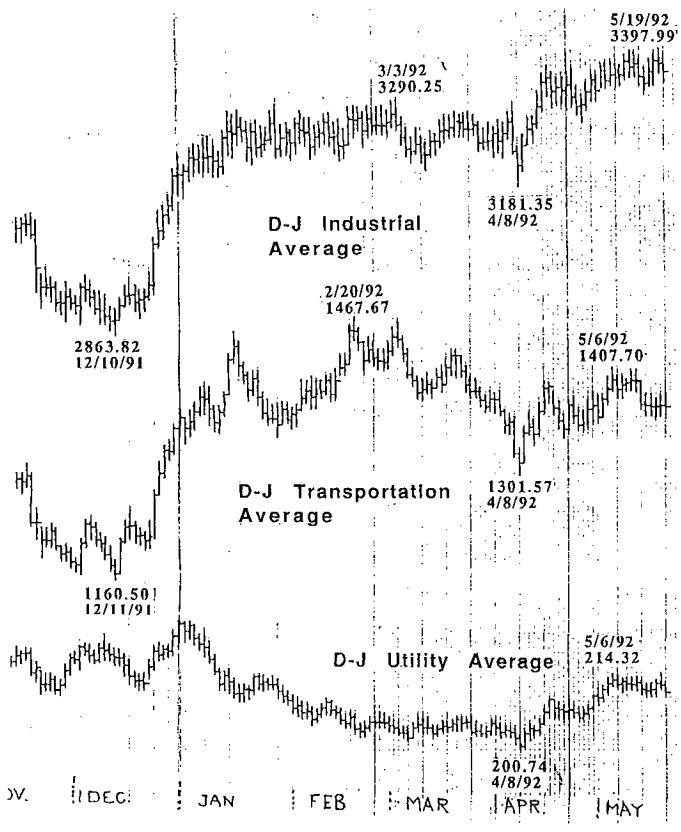
May 15 DJIA 3353.08; PTI 3483; A-D Ratio -10.05
May 21 DJIA 3378.71; PTI 3485; A-D Ratio -10.11
Dow Yield: 2.77%; Dow Price/Earnings: 53.9
Dow 200-day MA: 3134; Dow 30-day MA: 3348
Dow Times Book Value: 2.51; PTI 89-day MA: 3462
Percentage of Undervalued Blue-chips: 9%

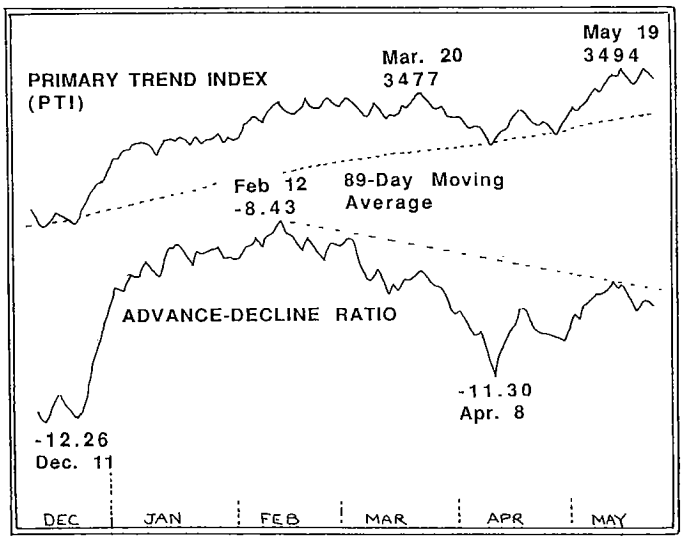
For instance, most recently the yield on the S&P 500 Composite was down to 2.78%. We know that in the past when the yield on the S&P 500 dropped below 3% -- six months later the S&P was down an average of 1%, one year later the S&P was down an average of 5%, and two years later the S&P was down an average of 10%.

We also know that tabulating all the quarterly periods from 1926 to the first quarter of 1991, the S&P 500 held in the 2.8% yield area for only five quarters. In other words, when the yield on the S&P 500 is down to 2.8%, the S&P has never remained there for very long.

Still, the above statistics do not provide us with an exact timing device. They simply tell us that when the S&P is in the 2.8% yield area, the odds on a stockholder being ahead in his investments over the next year or the next two years are poor, very poor.

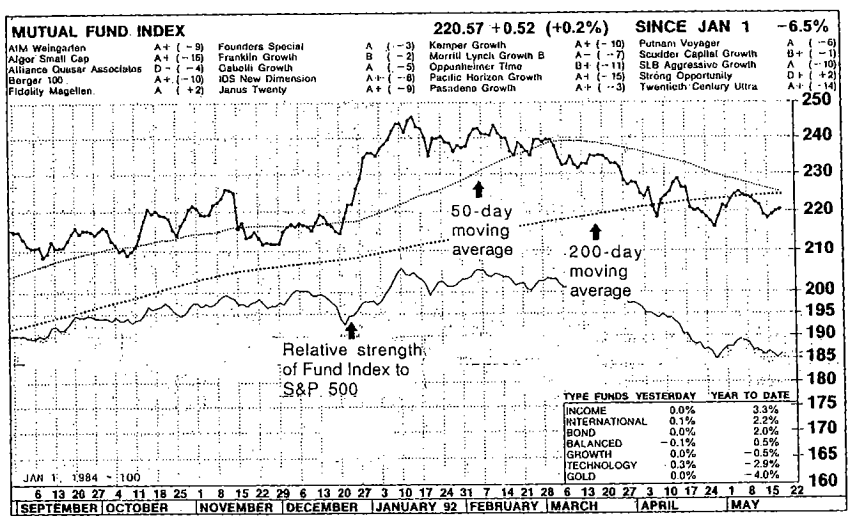
Despite the historical records, the public has been pouring money into this market (largely via mutual funds) in record amounts. In the first quarter of 1992 the public flooded the mutual funds market to the massive tune of $25 billion. On top of that, the institutions and funds are also heavily invested in stocks. Obviously, the public and the majority of institutions and funds are expecting higher prices. The public's thought process runs something like this: "I





can't seem to beat this stock market on my own, and I'm not getting any real return on my CDs and money market funds. So I'll just cash out and send the money to a mutual fund and let those smart professionals make money for me."

So far that line of reasoning hasn't worked out very well. In fact, in most cases it hasn't worked out at all. For proof, I'm including this chart of the Mutual Fund Index (courtesy of *Investor's Business Daily*). This is a daily average of 20 leading mutual funds. This Index turned down in early January, and it has been sliding ever since -- even while the public was pouring money into the funds.



Since January 1 the Mutual Fund Index has lost roughly 6.5% of its value. Figuring that an investor could have received roughly 2% on T-bills or CDs during the last six month, and then figuring a loss of 6.5% in mutual funds, that represents a total swing-loss of 8.5% on the switch out of money instruments and into mutual funds.

Note on the chart that the 50-day moving average for the Fund Index is close to breaking below its 200-day moving average. This would constitute a technical sell signal for most mutual funds, and it certainly would not be a good omen for the market.

What about the market? I've discussed the market's overvaluation endlessly, so no need to elaborate on that area. But valuation studies do indicate that the stock market has been in a top area. Yet it is well to remember that tops are difficult -- they can drag out, they can push one or two averages to new high after new high, they can destroy the short sellers, and finally, they tend to lure the public in at absolutely the wrong time.

All right, if extreme overvaluation cannot help us in timing a top, what other avenues do we have? Personally, I use: (1) my Dow Theory studies of the Averages, (2) breadth/price studies, and (3) I rely very heavily on my PTI.

(4) Finally, let me borrow a thought from the Bible. The Bible tells us that "The wind bloweth where it listith." Translation: the wind goes where it wants to go. Applying that same thought to the stock market, we can say that "The market can go anywhere it wants to go" or "The market can do anything." Remember that and you'll save yourself a lot of hand-wringing and agony.

NEAR TERM: Looking at the current market from a Dow Theory standpoint, we see the Dow recently making a series of new record highs, the last being **3397.99** on May 19. But the new Dow highs have not been confirmed by the Transportation Average. We also have a persistently lagging Utility Average (the Utilities recorded their high back on December 31 at 226.15).

A few words about non-confirmations in the Averages. The Transports recorded their bull market high of **1532.01** way back on September 5, 1989. The Transports have not been above 1500 since. But the 1989 high was recorded so long ago, that I believe it has lost much of its significance.

However, we cannot ignore the more recent Transport non-confirmation. On February 20, just three months ago, the Transportation Average recorded its 1992 peak at **1467.67** (see page 1 chart). Since then, despite persistent strength and new record highs in the Dow, the Transports have been acting poorly. They are currently in a toppy formation (head-and-shoulders top?) and are over 90 points below their February 20 peak.

This most recent Transport non-confirmation is important. And in view of this non-confirmation the market student must ask himself, "Why, in the face of strength in the Dow, have the carriers been unable to better a peak made only three months ago?" Keep in mind that the Transportation Average represents the sales and shipping capabilities of the nation. As I see it, the persistent refusal by Transports to confirm represents a danger signal for Dow Theorists. The Transport non-confirmation also raises questions about the strength of this so-called business "recovery." (As subscribers know, I personally am of the opinion that the recession never ended.)

PRICE/BREADTH: We also have a series of non-confirmations between the Dow and the advance-decline ratio, and I included charts showing this situation in the last two Letters. The A-D ratio topped out at -8.43 on February 12 (see page 2 chart). The downward path of the A-D ratio after February 12 tells us that despite the series of new highs in the Dow, since February 12, more issues on the NYSE have declined than advanced. This jibes with the poor action of the Mutual Fund Index, and it explains why mutual fund buyers have had so much trouble trying to keep their heads above water.

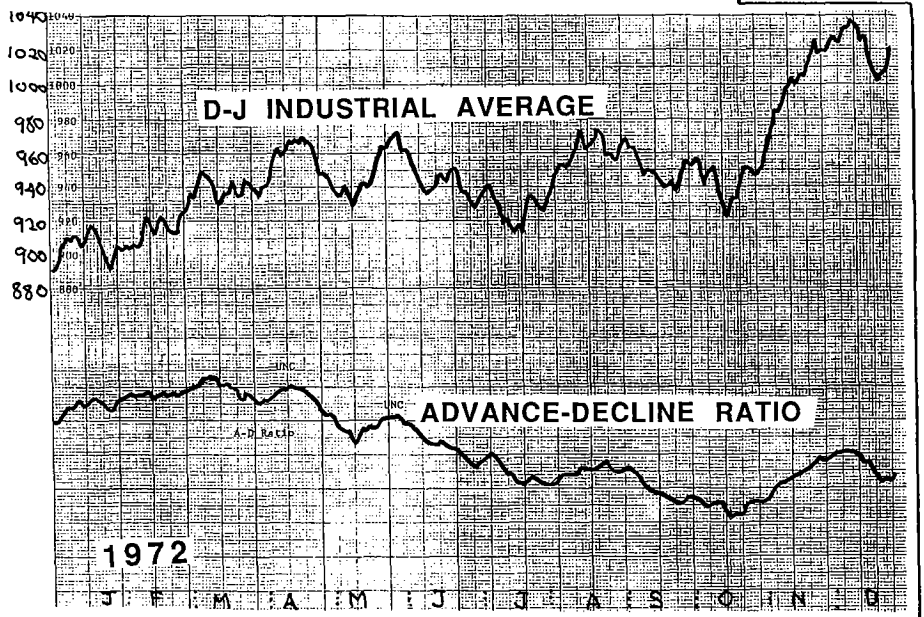
Next, let's turn to my Primary Trend Index. The PTI and the Dow have been recording new highs, even while the bulk of the market has been moving sideways or actually down. What has actually happened is that the Dow has acted as the cover-up for a weak or sloppy market. "Dow Hits New Highs" is the headline we've been reading in our local newspapers, even while the majority of stocks is sliding or doing nothing.

Nevertheless, the rising PTI has acted as a technical "floor" under the market, preventing it from spilling, preventing it from doing anything dramatic on the downside. I've stated in dozens of previous Letters that *when the PTI is in a rising trend, the market may not advance, but it is not going to fall apart either.* Yet it is disturbing when a rising trend in the PTI fails to take the advance-decline ratio or the major composite stock averages up with it. Which is exactly what's been happening during almost all of 1992.

From here on it will pay us to give careful attention to the trend of the PTI. If the PTI can hold or continue to move to new highs, the

stock market will either hold or move higher. But if the PTI turns decisively down, the whole character of this market will change, and the bear will take over.

So the big question now is -- the direction of the PTI? Will the PTI turn down, break below its 89-day moving average and continue down, or will it continue in its bullish mode? Unfortunately, I can't predict the forthcoming direction of the PTI. But for now, despite one of the most erratic stock markets in years, the PTI continues in its bullish mode.



COMMENT: For what it's worth, in talking to Marty Zweig a few weeks ago in NYC, we both felt that this market reminded us more than anything else of the 1972 stock market. So saying, let's look at a chart of the Dow and the A-D ratio for that year (chart from my A-D ratio album).

The A-D ratio recorded its high in early March of 1972. In April the Dow rallied to a new high, but the A-D ratio failed to confirm. The broad market (as measured by the A-D ratio) declined into July, then rallied. The Dow struck another new high in August, but again the A-D ratio failed by a wide margin to confirm. The market then sold off into October with the A-D ratio making new lows. But in October the Dow refused to confirm the new A-D low.

The non-confirmation led to an explosive October to December rally by the Dow, and this time the A-D ratio followed rather impressively, actually rising slightly above its August high. In November, Nixon was re-elected president, and the market rallied into January.

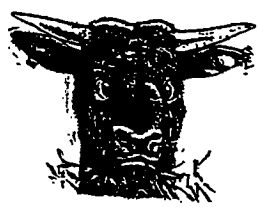
On January 11, 1973, the Dow closed at an all-time high of 1051.70. The A-D ratio again failed to confirm. Furthermore, the Transportation Average, which had been sliding throughout most of 1972, failed by a wide margin to confirm the new Dow high. Bonds, by the way, were in a rising trend all during 1972. Gold turned strong during 1972 and continued strong all during the year.

The January 11 record Dow high (remember, it was unconfirmed) marked the end of the bull market. What followed was the worst bear market since the 1930s.

So that's the story of the strange, erratic market of 1972, a market that kept all of us guessing and wondering, a market that proved to be the preamble to an horrendous two-year bear market.

INVESTMENT POSITION: Russell, you keep pointing to overvaluation in this market, non-confirmations, erratic action and so forth, but the bull remains in the box. Question -- how will we know when it's actually a bear market?

Answer: Easy, the bull will be out of the box and a bear will be in. But to be serious, when the primary trend turns bearish, the PTI will head down, break below its moving average, and keep going down, down and down. It will go down as relentlessly as it has been going up in recent years. Finally, it may lag, but it will arrive -- I'm talking about a classic Dow Theory bear signal. A bear signal entails (1) an important leg down by the Industrials and Transports, (2) an upward correction, and (3) BOTH Averages then turning down and breaking below the lows of the first down-leg.



However remember -- this has been a very tricky bull market, and the up-moves have tended to be very persistent and extended. Therefore, it would not surprise me if the first down-leg in the next bear market will also be very persistent and extended. Consequently, those waiting for an "official" Dow Theory bear signal before selling could have a long and costly wait.

This is the reason that Dow Theorists never wait for a bear signal before selling (or a bull signal before buying). When sufficient indications of a top are present, Dow Theorists sell. And then they wait with the proverbial "patience of 10 men."

Example: Those subscribers who were with me in 1974 remember that we bought in December 1974 well before a Dow Theory bull signal appeared. In December all the elements of a major bear market bottom were present. The later bull signal merely confirmed that our early buying had been correct.

Our position? Our investment position is to be very conservative, very careful, and largely defensive, which means ideally T-bills, top-grade money market funds, and a position in gold.

In recent Letters I did talk about (1) the Hong Kong market which I like and (2) the opening of China. To the previous recommended list, add an ADR called Dairy Farm, which is not a dairy farm, but a super-market chain which is expanding rapidly into southern China. Winsor Industrial is a textile company that would seem to have a very bright future in China. By the way, there's hysteria in the southern Shenzhen Exchange in China as people fight to invest in a limited number of Chinese shares. "B" shares (reserved for foreigners) have soared up to 45% in the past few weeks, following the wild demand for the "A" shares (shares that can be owned by Chinese citizens). Stock market fever is sweeping across China, where, it turns out, the Chinese people have huge hoards of savings, and those savings are looking for a place to go.

NOTES & QUOTES: A new *LA Times* poll shows that Bush's popularity in California has reached a new low. The poll shows that Bush would lose in California to Perot with 39% of the votes going to Perot and 26% to Bush. I note that both Clinton and Bush are now taking Perot very seriously. *Sindlinger & Co.* notes that in seven speeches in April Bush used the words "change" or "reform" 188 times. It doesn't seemed to have helped.

How about Texas? Here it appears that Perot would take the state. Perot is a hero in Texas. Furthermore, Texans would rather vote for a real, live, gen-u-ine Texan than a fake Texan like Bush who spends literally no time in the state and lists his address as being in a rented room in a hotel that is in bankruptcy. Without Texas and California, neither Bush nor Clinton could garner enough electoral votes to win the presidency. At that point, the election would be thrown into the House of Representatives. Supposing Perot captured the popular vote but the House (being controlled by the Democrats) chose Clinton? If that happened, the whole country

could resemble a version of the LA riots. Ya know, it's shaping up as quite a year.

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In the mid-1980s the IRS via research teams figured that Americans spent 5.4 billion hours a year on records, tax instructions and filling out forms. When figured along with the cost of accounting firm charges and tax-compliance costs, Howard Ruff (*The Ruff Times*) figures that Americans spent a total of $159 billion on tax compliance in 1985 or 24% of all tax revenues (and, of course, it's higher now). Russell comment: these figures are a national disgrace, and the only answer is the FLAT TAX. But unfortunately, the country may have to go broke before it can see the advantages of the flat tax.

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The European Community is going to have one major Central Bank. But the question is -- where? The logical choices are London, Paris, or Frankfurt, with each nation vying for its own city. But a growing thesis is that the bank should be outside one of the continent's three largest financial centers (this would avoid claims of an unfair advantage by England, France or Germany). So where to? The favorite compromise is Amsterdam.

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The cornerstone of the European exchange-rate mechanism is the D-mark. Many years of conservative sound money policy made the D-mark the ideal currency for the various European nations to tie their own currencies to. But the German unification has, ironically, now given Germany the highest inflation rate in Europe. Furthermore, in the first quarter the broad M-3 German money supply has risen at almost a 10% rate. To counteract the inflationary forces, the Germans have upped their interest rates. Since the other important European currencies are tied to the D-mark, they too have had to up their rates to keep their currencies within the "band." This upward pressure has thrown many European countries into recession or near-recession. But Europe still believes the D-mark is the best currency to be tied to. The proof of Germany's anti-inflation bent is that the German long bond yields are lower than any other long bond in Europe. That's telling us that for the future, Europe still has faith in the Bundesbank's steely stand against inflation.

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The state of California's finances have reached the emergency stage. Last summer Governor Wilson estimated the state's revenues for April would climb 37% above April a year ago. Wilson was a bit off. Actually, revenue for April dropped 25% below April 1991. The shortfall for April was $2 billion. California's taxes are already painful and many individuals and businesses are escaping the pain by leaving the state, a process which pushes up unemployment. So it would seem that raising taxes is out. What's left? Huge cuts in the state's spending. It's going to be an interesting year for California and Governor Wilson (who, it is said, is thinking in terms of being president).

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California used to be the "growth state" with San Diego County being one of the prime growth areas in the state. What's happening now? In SD County, first quarter figures show that the number of foreclosures for all properties topped last year's first quarter by nearly 113%, rising from 358 to 764. Total values for foreclosed properties shot up 300% to $254 million compared with $85 million last year. In my home-town La Jolla, according to the County Record Service, in 1987 there were about four defaults filed a month. For the first three months of 1992 there were 25 defaults filed per day. Said the regional director for Price Waterhouse, "Owners have continued to carry buildings until they woke up and said, 'There's no equity in this building.' They've reached the threshold of pain."

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The world is crowded, but it's going to get more crowded. The United Nations Population Fund said in its annual report that the world's population is growing at a faster rate than ever and consuming resources at an unprecedented rate. "Together these two crises . . . heighten the possibility of future economic and ecological catastrophe, the nightmare of the 1990s." The report projects that the world's population will be 5.48 billion by mid-1992 and grow to 6 billion by 1998, which is two years earlier than forecast a decade ago. The revised long-range projections from the UN say that the world will add an average of 97 million people a year, highest in history. Russell comment: That's at the rate of a new USA every 2.5 years. But why worry, it's just something else for our kids to worry about.

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Hong Kong/China/Asia. A government-owned Japanese bank is preparing a huge loan for the Bank of China. This is taken to be a sign that Tokyo wholeheartedly supports the new reforms in China . . . Quangdong, China's richest province, has unveiled an economic expansion program that will allow overseas banks to set up branches there. Furthermore, local Chinese banks will be allowed to open branches . . . Taiwan's trade surplus in April boomed 427% above a year earlier. Trade officials attributed the surge in exports mainly to rapid growth in shipments to Hong Kong, the main conduit for Taiwan's exploding trade in China . . .

The city of Shenyang, competing to be the site of China's third stock market, has opened a securities-exchange center trading in bonds. The Chinese people are said to be lining up to buy bonds and stocks in all three of China's exchanges.

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The word is that the ruble will be backed by dollars -- $6 billion of them. The current exchange rate is 175 rubles to the dollar, but the new conversion rate will be something like 120 rubles to the dollar. That date for ruble conversion is said to be August 1.

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How about the dollar? My old buddy, R.E. McMaster (*The Reaper*) is skeptical. In his most recent report he writes, "Often times before a person dies, he gets better for a short period of time. It seems that he's given just enough grace to become lucid, clean up his affairs, and say goodbye to his loved ones before passing on. I keep waiting for this to happen to the US dollar, for it to have one big final comeback before the world's reserve currency collapses and the *New World Order* can raise up the Phoenix with a new one-world gold-backed currency." Russell comment: Sounds possible to me, and a balanced-budget amendment might be just the thing to send the dollar up on a final big rally.

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Time Warner, the world's largest media group, is a fascinating study. The company was built on massive debt, and last year it paid out $966 million just to service the debt. Time Warner is now in the process of restructuring its debt, and Steve Ross, its CEO, is known never to sell anything and also to love complicated deals. Some of the story is told in the book, "The End of Time," written by former Time exec. Richard Clurman. Ross' style was blasted by Senator Abe Ribicoff, who quit the Warner Communications board in 1987. Said Ribicoff, "I have never in my life been with a board so subservient to the CEO. You have a bunch of morons on the board completely manipulated by Steve Ross, stooges to give Steve Ross anything he wanted." One of the things Ross wanted was a 10-year $196 million compensation package which included $78 million in 1990 and more than $70 million in stock options in 1991.

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Two weeks ago multi-millionaire David Geffen amazed NY and Hollywood by buying ALL the outstanding bonds owed by his good friend, clothes designer Calvin Klein. The issue was $68 million, and it is thought that Geffen paid $35 to $40 million for the bonds. Furthermore, Geffen will not ask for interest on the bonds, for perhaps up to five years. When queried by a reporter for *Women's Wear* about his investment, Geffen said, "I don't think they can blow it. Calvin is a total winner." Geffen added, "Look, honey, it doesn't represent 5% of my net total worth."

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People don't seem to understand how the Fed can pump up the potential money supply. One way is this: the Fed buys bills, notes or bonds from the banks. How does it pay the banks? It simply credits the bank's reserves at the Fed. This process reduces the bank's holding of securities and increases the bank's reserves. And it creates money (credits) out of thin air. The process gives the banks more money to lend. Whether the banks lend the money is another story, however.

* *

One place where weak prices have been a boon is in the newspaper business. There advertising lineage has been poor and circulation

has been fair to poor. But one of the papers' huge expenses, newsprint, has been cheap. The list price for newsprint in the eastern US is $685 a metric ton, but there have been huge discounts. Newsprint is now selling for as much as 45% off the list price. In fact, the newsprint business has been so bad that some plants have shut down. And much as they like cheap newsprint, this worries the newspapers. Actually, the newspapers would like business to get good enough so that they could afford a boost in newsprint prices. So far, that just hasn't happened.

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Before the advent of TV (and with a smaller US population), US movie houses would sell four billion tickets a year. By 1960 (with most homes in the US owning a TV set) tickets sales had dropped to one billion a year. The question now is whether the movie industry can hold on to those one billion admissions. The population is growing older, ticket prices have pushed to the $7 range, and many people are afraid to go out at night. In a recent poll, 40% of those polled said high ticket prices kept them from going to the movies. Personally, I prefer renting a film and seeing it on my wide-screen TV at home. And if the film is poor I turn off the set and read a magazine instead. Saves time and avoids the frustration of paying $14 (for Faye and me) and sitting through a boring show.

* *

What ever happened to the nickel cup of coffee? It went to a dime, a quarter, a half dollar, and most recently an unconscionable three bucks in fancy New York restaurants. But the price of coffee at wholesale has just dropped to a 20-year low. Coffee was $1400 a metric ton in December. Last week it dropped to $900 a ton, down over a third in five months! But is the price of a cup of coffee coming down at your local hash-house? Hardly. Aw, I don't care. I gave up drinking coffee (even decaf) two years ago. Coffee is a strong stimulant, and it's a powerful diuretic. I'm happier without it. I drink a glass of half orange juice, half grapefruit juice instead.

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Las Vegas: Faye and I spent two days at Las Vegas where I spoke at the huge Las Vegas "Money" show produced by *ISI* (Kim and Charles Githler). It was the biggest seminar ever with over 5,000 people attending. The seminar was at the Riviera, but Faye and I stayed at the amazing new Mirage. The place has 5,000 rooms, live white tigers, dolphins, a volcano that erupts at night, a massive swimming pool, and a veritable river in front with spectacular waterfalls. I went down to the gigantic gambling casino at 2:30 AM and there were still hundreds of people relentlessly throwing their money at poker, baccarat and countless slot machines. Las Vegas is not just for gambling, it's for eating. You can totally pig out for $8 to $12 a day. Typical at many hotels is breakfast -- $2.89, lunch -- $3.89, dinner -- $4.89 including prime rib, and "all you can eat" at all three meals. We ate breakfast at Harrah's which serves around 5,000 people daily. We ate early Sunday, so we missed about 4,800 people -- and the quality of food is good. One place offers "The Flush," two pancakes, two strips of bacon, two eggs and two sausages -- price $1.89.

Gambling: We visited the huge new Excalibur Hotel (4,000 rooms). Faye attacked one particularly attractive 25 cent slot. She was ahead for a brief moment, then got wiped. Specifics -- Faye put four quarters in the slot, moved ahead to $1.25, then lost five quarters in a row. I told her that she had to learn to quit while she's ahead. True, our total loss was $1.25, but it hurts to leave a loser, particularly when you had the house beaten.

Now seriously, if you go to Vegas don't miss the auto museum at the Imperial Palace -- it's amazing. They have a collection of 500 meticulously restored classic autos, with 200 on display at any given time. One room has the world's largest collection of the fabulous Duesenburgs, and those huge cars are BEA-UTIFUL. The conference was a smashing success and everybody seemed happy and edified (and believe me, no one came away hungry). Final notes: It's HOT in Vegas, 93 during the day, gorgeous at night. Clothes, anything goes, and I mean anything. People -- all kinds and varieties, but more obese human beings than I've ever seen in one place before. I doubt if they've ever heard of Jenny Craig in Vegas.

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The public and the car mags loved Honda's CRX. Now Honda has come out with a CRX hardtop convertible. Here's *Popular Science's* description of the action as the hardtop roof drops into the trunk at the rear! "The CRX is a marvel to watch. As the 45-second cycle starts, the trunk lid rises to roll-bar level, while the aluminum hardtop lets down at the rear. Carrier arms thrust forward from under the lid to grip the roof panel, then draw it back along the guide channels. The trunk lid then drops down to its normal position to complete the operation." Wow, I've got to see this one.

* *

Of all the ethnic groups, the blacks are the only ones who have been *totally cut off from their own roots -- their own backgrounds.* The mechanism of the cut-off was slavery. I have always felt that slavery was the ultimate evil, the results of which this nation never paid for. A hundred and fifty years ago the famous historian, Alexis de Tocqueville, wrote that "the most formidable of all the ills that threaten the future of the United States" arose from the existence of a black population that had undergone the "calamity" of slavery. "If ever America undergoes great revolutions, they will be brought about by the presence of the black race on the soil of the United States; that is to say, they will owe their origin not to the equality but to the inequality of conditions among Americans." Prescient words.

The condition of blacks today borders on the horrendous. Today blacks comprise almost half of the US prison population. The homicide rate for black males aged 15 to 24 has jumped 40% since the mid-1980s and is now the leading cause of death for that age group. Forty percent of those murdered in the US are black men killed by other black men. Sixty-five percent of all black babies are born to unwed mothers, and in some inner cities it is as high as 80%.

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American prisons are filled to overflowing. Yet, ponder these incredible statistics: Nearly three out of every four convicted criminals are NOT sent to prison. Fewer than one in 10 serious crimes result in imprisonment. The majority of criminals spend less than half their time behind bars. What would happen if say most of those convicted of criminal acts went to prison?

Today there are many more violent crimes and therefore prison terms tend to be longer. As a result the US prison population is growing older. Today there are an estimated 20,000 to 40,000 prisoners over the age of 55. Most prisons have been built according to the model of a young, dangerous, healthy prisoner, but that model is becoming obsolete. The problem: older prisoners need more medical care and attention, and the cost for keeping an older prisoner can be around $60,000 a year. Thus, prison costs are booming, and the squeeze increases on states' finances.

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Here's an interesting thought. Did you ever notice that the men's magazines deal pretty much with fantasy -- what men dream about, what men would like women to look like and be like. But women's magazines deal with an entirely different subject -- fear. "What do you do when your husband leaves?" -- "Are you too fat?" -- "Is your boyfriend tiring of sex?" -- "Is your face showing wrinkles?" My conclusion is that men don't see themselves in reality where it concerns women, love and sex. And women's fears are a reflection of men fantasies. Women worry that they're not pretty enough or sexy enough to attract a man, or women worry that once they find a man they're not pretty enough or sexy enough or smart enough to keep him. With men so lost in fantasy-land, it's a wonder women want men at all. But they do.

INFLATION IN OUR FUTURE? My answer is "Yes," and I can base this on the whole Social Security package alone. This is how SS works. Although most people don't realize it, the so-called "surplus" in the SS program is actually a huge deficit. While the politicians, for political reasons, prefer to call the deficit a surplus, there are three places where the SS fund is reported as a DEFICIT. (1) Table 6D of the Treasury's *Monthly Treasury Statement of Receipts and Outlays,* (2) the *Winter Treasury Report,* and (3) the *Statement of Liabilities and Other Financial Commitments of the United States Government.* By law, number 3 must be printed and

submitted to the entire Congress but it is doubtful whether any of them read it.

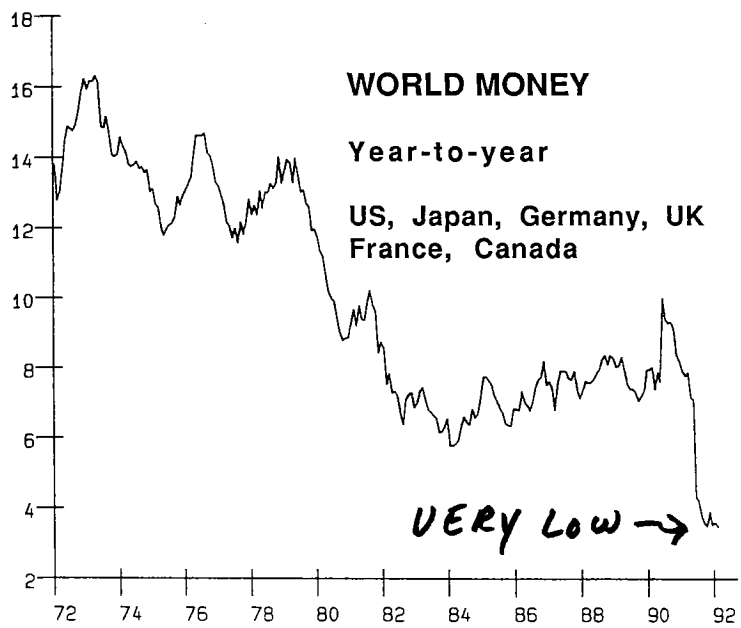
Here's what happens. The SS Administration each year turns over all its unspent funds to the Treasury in return for non-negotiable interest-bearing IOUs. So instead of building up a huge mass of surplus funds, the SS Administration has a massive collection of IOUs from the Treasury.

How big is this SS deficit? Nobody knows for sure, but one report by Gary North estimates that the total could be as much as $15 to $18 trillion. How did it all start? In 1965 Lyndon Johnson decided to mix Social Security with the general fund so he could finance the Vietnam War as well as keep the Great Society alive.

Here's an excerpt from a 1976 hearing: Senator Wm. Proxmire: "There are 37 million people, is that right, that get Social Security benefits?" Social Security Commissioner James Cardwell: "Between 32 and 34 million." Proxmire: "I am a little high; 32 to 34 million people. Almost all of them, or many of them, are voters. In my state, I figure there are 600,000 voters that receive Social Security. Can you imagine a senator or congressman under those circumstances saying, 'We are going to repudiate that high a proportion of the electorate.'? No. furthermore, we have the capacity under the Constitution, the Congress does, to coin money, as well as to regulate the value thereof. And therefore we have to power to provide that money. And we are going to do it. It may not be worth anything when the recipient gets it, but he is going to get his benefit paid." Cardwell: "I tend to agree."

Russell comment: How will the government pay off these monster liabilities? It's obvious, they will pay them off with US dollars. But since the dollar is now disconnected from gold, there is no, absolutely no, official definition of a dollar. The dollar is not now, as it once was, defined in terms of a certain amount of gold. The dollar simply floats free against other currencies. As the time approaches to pay off Social Security and other liabilities, the pressure will increase to publish, print, manufacture more dollars. This process is called inflation. The government, as it moves further and further into the 90s, will have to make the decision either to "inflate or die." Which way will they decide? You figure it out.

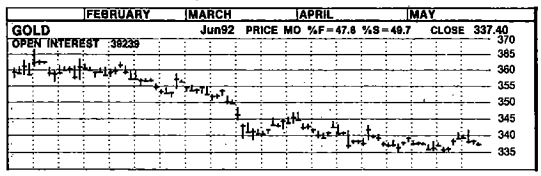
DEFLATION? In the meantime, rather ironically, deflationary forces have descended on the developed nations. This chart (courtesy of *ISI* and Ed Hyman) shows that world money growth, on a year-to-year basis, has collapsed to a record low. Part of this phenomenon is intentional -- it's due to the various central banks putting the brakes on as they attempt to hold back inflation. But as European economies slow down, as the demand for "prosperity" forces itself on the world's politicians, the pressure will be on the central banks to reverse this chart, to jazz up the money supply.



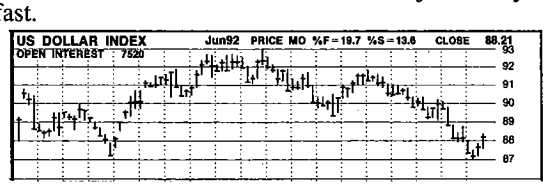
In troubled Germany the inflation rate has already moved up to 5.7%. Furthermore, there is pressure and discontent with almost every administration in Europe. So will the world's money supply remain low? Will inflation will be held in check? Color me "skeptical."

PRECIOUS METALS: The gold stocks often lead the metal both on the upside and the downside. The XAU silver/gold stock index hit its low on April 8 at **67.56.** Since then it has climbed to the 76 level where it is now. The lowest second London fix for gold was **335.80** struck on May 12. My own guess is that those two numbers, 67.56 and 335.80, are going to mark the lows.

This gold chart (courtesy of *Investor's Business Daily*) shows gold appearing to have made a flat bottom -- even while commentators were telling us that gold was an archaic relic and no longer needed in the world monetary system. Ah, where have we heard that one before. At any rate, its more of the "long wait" for gold bulls. But maybe, just maybe, a 12-year bear market is coming to an end.



Meanwhile, the Dollar Index has been doing a swan-dive but may finally have found support at the 87 level. If you're going to Europe this summer, take plenty of greenbacks. The dollar doesn't buy much there, and it takes a load of them to just to buy a decent breakfast.



LATE NOTES: More of the same -- the Dow tends to hold up while the majority of NYSE issues slide. Every other market advisory and mutual fund claims (in newspaper advertisements) that "It is Numero Uno," and it amazes me that so many people can be so brilliant during difficult markets. General Motors came out with the biggest stock offering in history, and the issue was gobbled up like it was a two-dollar IPO.

I keep watching those Transports -- the non-confirmation here is flagrant. The lagging A-D ratio is also enough to give a veteran market student white knuckles. Maybe the only indicator that is telling the real story is my PTI. It's been holding stubbornly above that critical 89-day moving average.

Question: Why are there so many investment advisors still living in California? If we had any brains, we'd be living in a no-tax state instead of living in a state where they tax everything that moves. Despite the fat taxes, the projected budget deficit for California this year has reached $11 billion (that's eleven billion, and this after last year's biggest tax boost for any state in history). The budget cuts coming up in the Golden State are going to be whoppers, eye-openers.

I could live in Washington (no state taxes) but it's too rainy. I could live in Florida (no state taxes) but too much humidity and too many bugs. I could live in Alaska (no state taxes) but too cold. I could live in Nevada (no state taxes) but too hot. Aw, I guess I'll stay in California. I'll pay the darn taxes, keep a Colt 45 by my bedside and just stay out of gang territory.

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